

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

REPORTING OF ACCOUNTS PAYABLE FOR THE
NATIONAL GUARD AND RESERVE EQUIPMENT
APPROPRIATION ON THE "OTHER DEFENSE
ORGANIZATIONS" PORTION OF THE
FY 1996 FINANCIAL STATEMENTS

Report No. 97-215

September 18, 1997

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Department of Defense

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Acronyms

DFAS
NGREA

Defense Finance and Accounting Service
National Guard and Reserve Equipment Appropriation



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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September 18, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)

SUBJECT: Audit Report on Reporting of Accounts Payable for the National Guard and Reserve Equipment Appropriation on the "Other Defense Organizations" Portion of the FY 1996 Financial Statements (Report No. 97-215)

We are providing this audit report for review and comment. We performed this audit in response to the Chief Financial Officers Act of 1990 and the Federal Financial Management Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Because the Under Secretary of Defense (Comptroller) did not comment on a draft of this report, we request that the Under Secretary of Defense (Comptroller) provide comments on the final report by October 20, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9426 (DSN 664-9426) or Ms. Dianna J. Pearson, Audit Project Manager, at (703) 604-9424 (DSN 664-9424). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

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Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-215

(Project No. 7RE-2002.02)

September 18, 1997

Reporting of Accounts Payable for the National Guard and Reserve Equipment Appropriation on the “Other Defense Organizations” Portion of the FY 1996 Financial Statements

Executive Summary

Introduction. The audit was performed in compliance with Public Law 101-576, “Chief Financial Officers Act of 1990,” and Public Law 103-356, “Federal Financial Management Act of 1994.” Public Law 103-356 requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. On June 6, 1995, the DoD Deputy Chief Financial Officer advised the DoD Components of the requirement to prepare and submit financial statements in accordance with the Federal Financial Management Act of 1994.

Fiscal year 1996 marks the first year that financial statements have been prepared to report the financial position and results of operations for the DoD reporting entity entitled “Other Defense Organizations.” The financial information for the “Other Defense Organizations” entity is included in the consolidated FY 1996 DoD financial statements. The Defense Finance and Accounting Service Indianapolis Center prepared the financial statements in accordance with DoD guidance on the form and content of financial statements as adopted from Office of Management and Budget Bulletin No. 94-01, “Form and Content of Agency Financial Statements,” and subsequent issues. The Defense Finance and Accounting Service Indianapolis Center prepared the financial statements from a consolidation of accounting information reported from multiple field-level and departmental-level accounting systems.

Audit Objectives. The audit objective was to evaluate the FY 1996 financial information reported for the National Guard and Reserve Equipment Appropriation. Specifically, we reviewed the process that the Defense Finance and Accounting Service centers used to report accounts payable for the National Guard and Reserve Equipment Appropriation. We also determined the effect of any noncompliant actions on the FY 1997 financial statements. In addition, we assessed compliance with laws and regulations and reviewed the management control program as it related to the overall objective.

Audit Results. The Defense Finance and Accounting Service Denver Center correctly reported accounts payable for open and closed appropriations. The Defense Finance and Accounting Service Cleveland Center and the Defense Finance and Accounting Service

Indianapolis Center did not report accounts payable remaining on closed appropriations for the National Guard and Reserve Equipment Appropriation. As a result, accounts payable for the National Guard and Reserve Equipment Appropriation are understated by \$12.8 million on the "Other Defense Organizations" portion of the FY 1996 DoD financial statements.

Recommendation. We recommend that the Under Secretary of Defense (Comptroller) revise the DoD "Guidance on Form and Content of Financial Statements for FY 1997 Financial Activity" to specify the reporting requirements of accounts payable for closed appropriations.

Management Comments. We issued a draft of this report on June 27, 1997. The Under Secretary of Defense (Comptroller) did not comment on a draft of this report. Therefore, we request the Under Secretary of Defense (Comptroller) to provide written comments by October 20, 1997.

Table of Contents

Executive Summary	i
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Part I - Audit Results

Audit Background	2
Audit Objectives	5
Reporting of Accounts Payable Remaining on Closed Appropriations for the National Guard and Reserve Equipment Appropriation	6

Part II - Additional Information

Appendix A. Audit Process	
Scope and Methodology	12
Management Control Program	13
Appendix B. Report Distribution	15

Part I - Audit Results

Audit Background

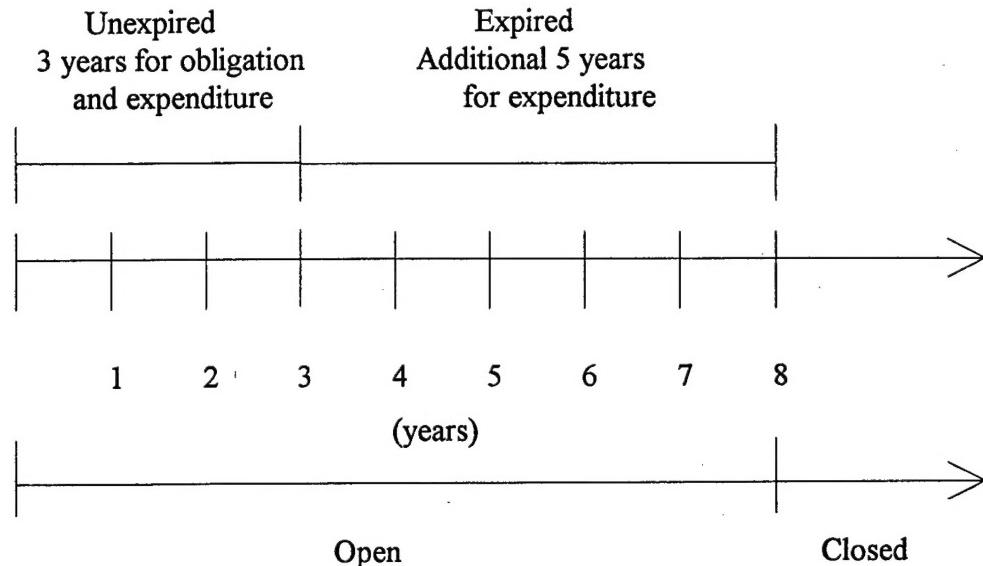
We performed the audit in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget. Public Law 103-356, the Federal Financial Management Act of 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. The consolidated DoD financial statements for FY 1996 included the financial information for the reporting entity entitled "Other Defense Organizations."

"Other Defense Organizations." The Department of the Treasury uses department code "97" to identify appropriations for the Office of the Secretary of Defense. The Under Secretary of Defense (Comptroller) allocates Department 97 appropriations to Defense agencies and Military Departments. The "Other Defense Organizations" reporting entity includes financial information for the National Guard and Reserve Equipment Appropriation (NGREA), as well as other Defense agencies and Defense appropriations.

National Guard and Reserve Equipment Appropriation. In 1981, Congress established the NGREA to provide the equipment needed to maintain the readiness of the National Guard and Reserve units. The Under Secretary of Defense (Comptroller) allocates NGREA to National Guard and Reserve components. The National Guard and the Reserve consist of the following six components:

- Army National Guard,
- Air National Guard,
- Army Reserve,
- Navy Reserve,
- Air Force Reserve, and
- Marine Corps Reserve.

Status of the NGREA. The NGREA is a multi-year appropriation, available for obligation for 3 fiscal years. When the NGREA is no longer available for obligation, it is expired. However, the NGREA is available for expenditure up to 5 years after the appropriation expires. Therefore, the NGREA is available for an 8-year period and is considered closed after that period. The figure below shows the timeline status of the NGREA.



Status of the NGREA

Defense Finance and Accounting Service. The Defense Finance and Accounting Service (DFAS) centers provide finance and accounting support for Defense organizations and Military Departments. The support includes maintaining departmental accounting records and preparing financial statements from both trial balances and reports on budget execution submitted by fiscal stations. Table 1 shows the DFAS centers that provide finance and accounting support for the Defense organizations and Military Departments.

Table 1. DFAS Centers and Supported Defense Organizations

<u>DFAS Center</u>	<u>Supported Organization</u>
Cleveland	Navy and Marine Corps*
Denver	Air Force
Indianapolis	Army and "Other Defense Organizations"
Kansas City	Marine Corps*

*The DFAS Kansas City Center and the DFAS Cleveland Center provided support for the Marine Corps Reserve NGREA because the Marine Corps Reserve NGREA is allocated to both the Navy and Marine Corps.

Trial balances and reports on budget execution for the National Guard and Reserve components are prepared by the cognizant DFAS centers. The DFAS centers then report the trial balances and reports on budget execution for Department 97 appropriations to the DFAS Indianapolis Center.

DFAS Indianapolis Center. In September 1994, DFAS transferred the responsibility for preparing the departmental accounting reports for Department 97 appropriations to the DFAS Indianapolis Center. The transfer was effective on April 1, 1995. Fiscal stations* report trial balances and reports on budget execution for Department 97 appropriations to their responsible DFAS center. The DFAS centers then report the trial balances and reports on budget execution to the DFAS Indianapolis Center. However, starting in FY 1997, fiscal stations will report trial balances and reports on budget execution for Department 97 appropriations to the DFAS Indianapolis Center.

Trial Balance. DoD 7000.14-R, "DoD Financial Management Regulation," volume 1, chapter 3, March 1993, contains key accounting requirements for DoD financial reporting. Key Accounting Requirement No. 1, "General Ledger Control and Financial Reporting," states that the accounting system must have general ledger control and must maintain an appropriate account structure approved by DoD. However, fiscal stations that support 19 of the 29 Defense agencies used data from sources other than general ledger accounting control systems to prepare trial balances. Accounting organizations used data from sources other than general ledger accounting control systems because the accounting systems that support the 19 Defense agencies were not complete general ledger accounting control systems. The need for complete general ledger accounting control systems is discussed further in Inspector General, DoD, Audit Report No. 97-017, "Consolidated FY 1995 Financial Report on Defense Organizations Receiving Department 97 Appropriations," October 31, 1996.

Report on Budget Execution. The report on budget execution (DD Form 1176) is a monthly report that is designed to show the status of funds for an appropriation. Fiscal stations prepare reports on budget execution for open appropriations and for closed appropriations that have financial activity during the fiscal year. Fiscal stations prepare reports on budget execution using field-level reports that are certified for accuracy and completeness.

*Fiscal stations are finance and accounting offices.

Financial Reporting Process at the DFAS Indianapolis Center. The DFAS Indianapolis Center verifies and adjusts trial balance accounts submitted by fiscal stations to the yearend departmental reports on budget execution. For example, the DFAS Indianapolis Center adjusts the accounts payable balance, submitted by the fiscal stations, to the accounts payable balance on the reports on budget execution. The adjusted trial balance accounts are then included in the "Other Defense Organizations" portion of the FY 1996 DoD financial statements.

Financial Statements. FY 1996 marks the first year for which financial statements have been prepared to report the financial position and results of operations of the DoD "Other Defense Organizations" in accordance with the Chief Financial Officers Act. The DFAS Indianapolis Center prepared the financial statements in accordance with DoD guidance on the form and content of financial statements as adopted from Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," and subsequent issues. The DFAS Indianapolis Center prepared the financial statements from a consolidation of accounting information reported from multiple field-level and departmental-level accounting systems.

Audit Objectives

The overall audit objective was to evaluate the FY 1996 financial information reported for the NGREA. Specifically, we reviewed the process that the DFAS centers used to report accounts payable for the NGREA. Also, we determined the effect of any noncompliant actions on the FY 1997 financial statements. In addition, we assessed compliance with laws and regulations and reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the audit scope and methodology and the review of the management control program.

Reporting of Accounts Payable Remaining on Closed Appropriations for the National Guard and Reserve Equipment Appropriation

The DFAS Denver Center correctly reported accounts payable for open and closed appropriations. The DFAS Cleveland Center and the DFAS Indianapolis Center did not report the accounts payable remaining on closed appropriations for the NGREA. The DFAS centers did not consistently report the accounts payable remaining on closed appropriations because the DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," which the DFAS centers used in reporting accounts payable, did not specify the reporting requirements of accounts payable for closed appropriations. As a result, accounts payable for NGREA are understated by \$12.8 million on the "Other Defense Organizations" portion of the FY 1996 DoD financial statements.

DoD Financial Management Requirements

DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity," October 1996, states that liabilities are to be recognized when they are incurred regardless of whether available budgetary resources cover them. In addition, DoD 7000.14-R, "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," January 1995, states that liabilities should be recorded regardless of the availability of funds to be used in their liquidation.

Reporting of Accounts Payable Remaining on Closed Appropriations for the NGREA

The DFAS Denver Center correctly reported accounts payable for open and closed appropriations. Table 2 shows the amount of accounts payable that the DFAS Denver Center reported for closed appropriations.

**Reporting of Accounts Payable Remaining on Closed Appropriations
for the National Guard and Reserve Equipment Appropriation**

**Table 2. Accounts Payable That the DFAS Denver Center
Reported for Closed Appropriations**

<u>National Guard or Reserve Component</u>	<u>Accounts Payable Reported</u>
Air Force Reserve	\$2,171,559
Air National Guard	<u>3,544,850</u>
Total	\$5,716,409

The DFAS Cleveland Center and the DFAS Indianapolis Center did not report the accounts payable remaining on closed appropriations for the NGREA. The DFAS Cleveland Center and the DFAS Indianapolis Center reported only accounts payable for open appropriations. Table 3 shows the amount of accounts payable that the DFAS Cleveland Center and the DFAS Indianapolis Center excluded for closed appropriations.

**Table 3. Accounts Payable That the DFAS Cleveland and DFAS
Indianapolis Centers Did Not Report for Closed Appropriations**

<u>National Guard or Reserve Component</u>	<u>Accounts Payable Not Reported</u>
Army Reserve	\$ 344,900
Army National Guard	0
Navy Reserve	0
Marine Corps Reserve	<u>12,453,462</u>
Total	\$12,798,362

Reporting Guidance

The DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" did not state how to report liabilities for closed appropriations on the "Other Defense Organizations" portion of the DoD financial statements. Although the DFAS Denver Center reported accounts payable for closed appropriations, neither the DFAS Cleveland Center nor the DFAS Indianapolis Center reported accounts payable for closed appropriations. However, for consistent reporting, the DoD form and content guidance should specify the reporting requirements of accounts payable for closed appropriations.

Reporting of Accounts Payable Remaining on Closed Appropriations for the National Guard and Reserve Equipment Appropriation

Effect of Not Reporting Accounts Payable

Because the DFAS Cleveland Center and DFAS Indianapolis Center did not report accounts payable for closed appropriations, accounts payable for the NGREA are understated by \$12.8 million on the FY 1996 DoD financial statements. Table 4 shows the effect on the amount of accounts payable reported for the NGREA.

**Table 4. Comparison of Amount of Accounts Payable
Reported for the NGREA**

NGREA Component	Amount of Accounts Payable Reported	Amount of Accounts Payable That Should Have Been Reported	Difference
Army National Guard	\$106,350,346	\$106,350,346	0
Air National Guard	40,860,431	40,860,431	0
Army Reserve	39,173,303	39,518,203	\$ 344,900
Navy Reserve	34,535	34,535	0
Air Force Reserve	8,001,705	8,001,705	0
Marine Corps Reserve	<u>70,754,247</u>	<u>83,207,709</u>	<u>12,453,462</u>
Total	\$265,174,567	\$277,972,929	\$12,798,362

We confirmed that the same condition existed in the other Department 97 general fund accounts as reflected in the "Other Defense Organizations" financial statements. Those accounts will be discussed in a future audit report.

Conclusion

The DFAS centers should report accounts payable for closed appropriations on the "Other Defense Organizations" portion of the DoD financial statements until the fiscal stations determine that the accounts payable are no longer valid. As stated in DoD financial guidance, liabilities are to be recognized when they are incurred. The DoD "Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity" did not specify the reporting requirements of accounts payable for closed appropriations. Future versions of the DoD form and content guidance should incorporate reporting requirements for accounts payable for closed appropriations.

**Reporting of Accounts Payable Remaining on Closed Appropriations
for the National Guard and Reserve Equipment Appropriation**

Recommendation for Corrective Action

We recommend that the Under Secretary of Defense (Comptroller) revise the DoD "Guidance on Form and Content of Financial Statements for FY 1997 Financial Activity" to specify the reporting requirements of accounts payable for closed appropriations.

Management Comments Required

The Under Secretary of Defense (Comptroller) did not respond to the draft of this report. We request that the Under Secretary of Defense (Comptroller) provide comments on the final report by October 20, 1997.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Scope. We reviewed the FY 1996 National Guard and Reserve Equipment Appropriation (NGREA) trial balances and reports on budget execution for the six National Guard and Reserve components. We performed the audit in response to the Chief Financial Officers Act of 1990 (Public Law 101-576), which established requirements for Federal organizations to submit audited financial statements to the Director, Office of Management and Budget.

Methodology. We tracked the flow of NGREA funds from the Under Secretary of Defense (Comptroller) to the fiscal stations. We then tracked the flow of reports on budget execution from the fiscal stations to the cognizant DFAS centers. At the DFAS centers, we reviewed the process used to crosswalk financial data from reports on budget execution to the trial balances. Specifically, we reviewed the process that the DFAS centers used to determine the amount of accounts payable. We also reviewed the DoD guidance, prepared by the Under Secretary of Defense (Comptroller), that the DFAS centers used in reporting accounts payable from closed appropriations. We discussed the issue with the Under Secretary of Defense (Comptroller) and determined that his office should revise the DoD form and content guidance to specify the reporting treatment of accounts payable for closed appropriations.

Use of Computer-Processed Data. We relied on computer-processed data but did not test the reliability of the data. We did not test the reliability of the data because we evaluated the process that the DFAS centers used to report accounts payable from reports on budget execution to the trial balances for the NGREA. Therefore, not establishing the reliability of the financial data did not materially affect the results of our audit.

Prior Audits and Other Reviews. In the last 5 years, no prior audits or other reviews have been completed on the process of reporting accounts payable from reports on budget execution to trial balances.

Audit Period and Standards. We performed this financial-related audit from September 1996 through June 1997 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available upon request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the management controls over the DoD guidance, prepared by the Under Secretary of Defense (Comptroller), that the DFAS centers used in reporting accounts payable for closed appropriations. We also reviewed the process the DFAS centers used to report accounts payable from reports on budget execution to the trial balances that support the "Other Defense Organizations" portion of the DoD consolidated financial statements.

Adequacy of Management Controls. We identified a material management control weakness, as defined by DoD Directive 5010.38, for the Under Secretary of Defense (Comptroller). The DoD guidance that the Under Secretary of Defense (Comptroller) prepared and the DFAS centers used did not specify the reporting treatment of accounts payable for closed appropriations. Specifically, the DFAS Cleveland Center and the DFAS Indianapolis Center did not include accounts payable for closed appropriations for the NGREA in the "Other Defense Organizations" portion of the FY 1996 DoD financial statements. The management control weakness resulted in a \$12.8 million understatement of accounts payable on the FY 1996 financial statements. The recommendation, if implemented, will correct the weakness for the FY 1997 financial statements. We will provide a copy of the final report to the senior official in charge of management controls for the Under Secretary of Defense (Comptroller).

Appendix A. Audit Process

Adequacy of Management's Self-Evaluation. The Under Secretary of Defense (Comptroller) did not identify accounts payable for closed appropriations as a management control weakness. We discussed the problem with the Under Secretary of Defense (Comptroller) and determined that the DoD form and content guidance needed to specify the reporting treatment of accounts payable for closed appropriations. The Under Secretary of Defense (Comptroller) has agreed to revise the DoD form and content guidance to specify the proper reporting treatment of accounts payable for closed appropriations. The revision of the DoD form and content guidance will correct the weakness in future reporting periods.

Appendix B. Report Distribution

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Senate Committee on Armed Services

Senate Committee on Governmental Affairs

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House Subcommittee on National Security, Committee on Appropriations

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House Subcommittee on Government Management, Information, and Technology,

Committee on Government Reform and Oversight

House Subcommittee on National Security, International Affairs, and Criminal Justice,

Committee on Government Reform and Oversight

House Committee on National Security

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